88-102

No.

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1988

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

MICHAEL F. FOLEY AND NANCY S. FOLEY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
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QUESTION PRESENTED

Whether a payment to the Church of Scientology for auditing or training sessions is deductible from taxable income as a "contribution or gift" under Section 170 of the Internal Revenue Code.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statute involved	1
Appendix A	1a
Appendix B	12a
Appendix C	13a
Appendix D	24a

TABLE OF AUTHORITIES

Cases:

Graham v. *Commissioner*, 83 T.C. 575 (1984), aff'd, 822 F.2d 844 (9th Cir. 1987), cert. granted, No. 87-1616 (May 23, 1988) 2, 3, 4, 5

Hernandez v. *Commissioner*, cert. granted, No. 87-963 (Apr. 18, 1988) 4, 5

United States v. *American Bar Endowment*, 477 U.S. 105 (1986) 4

Statute:

Internal Revenue Code of 1954 (26 U.S.C.):

§ 170 ..... 1, 4, 24a-25a

§ 170(c) 2, 24a-25a

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MICHAEL F. FOLEY AND NANCY S. FOLEY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-11a) is reported at 844 F.2d 94. The decision of the Tax Court (App., *infra*, 12a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on April 19, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

Section 170 of the Internal Revenue Code (26 U.S.C.) is set forth in pertinent part in a statutory appendix (App., *infra*, 24a-25a).

1. Respondents paid $5,881.83 to a branch of the Church of Scientology in 1976 and claimed that payment as a charitable deduction on their joint federal income tax return under Section 170 of the Internal Revenue Code,[1] which permits a deduction for a "contribution or gift" to certain eligible donees (see I.R.C. § 170(c)). On audit, the Commissioner disallowed that deduction and determined a tax deficiency of $975.92. Respondents filed a petition in the Tax Court for review of the Commissioner's determination. There was no trial in the Tax Court, however, nor any other evidentiary submission. Instead, the parties entered into a stipulation to be bound by "any relevant findings of fact or conclusions of law" (excluding those relating to "subjective intent") to be made by the Tax Court in three consolidated "test cases" that were to be tried. The stipulation further provided that the record in the test cases, "to the extent relevant," would be deemed part of the record in this case for the purpose of appeal. App., *infra*, 2a.[2] After the Tax Court decided the "test cases" in favor of the Commissioner (*Graham* v. *Commissioner*, 83 T.C. 575 (1984), aff'd, 822 F.2d 844 (9th Cir. 1987), cert. granted, No. 87-1616 (May 23, 1988), *reprinted at* App., *infra*, 13a-23a), the court entered a decision and order in the instant case "on the authority of *Graham*," finding a deficiency of $975.92 (App., *infra*, 12a).

2. In the *Graham* case, the Tax Court entered findings of fact pertaining to the general operation of the Church

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

[2] The government entered into the same stipulation with numerous other taxpayers who had filed petitions in the Tax Court challenging the denial of a charitable deduction for payments to the Church of Scientology.

of Scientology. Like respondents, the taxpayers in *Graham* had made payments to a branch of the Church of Scientology[3] and had sought to deduct them on their income tax returns as charitable contributions (App., *infra*, 17a-18a). These payments were made in exchange for "auditing" and "training" services provided by the Church. Scientologists believe that "auditing" helps an individual to achieve a higher level of "spiritual competence." Auditing is administered in a one-to-one session by a trained Scientologist who asks the auditee questions and measures his skin responses during the answers by means of an electronic device. "Training" courses study the doctrines of Scientology and are believed to yield further spiritual benefits. See *id.* at 15a.

The Church charges a "fixed donation" for training and auditing, which is almost never waived.[4] The Church "operates in a commercial manner" in providing these services (App., *infra*, 17a). It promotes its services through lectures and radio and newspaper advertising. It gives a standard discount for payments made well in advance of the services to be rendered, and it issues refunds of those payments if the services ultimately are not received. *Id.* at 15a-17a.

After making those factual findings, the Tax Court in *Graham* ruled that the payments in question were not contributions, but rather were non-deductible payments made

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[3] The Church of Scientology consists both of a central branch, the "mother" Church of Scientology of California, and of numerous branches that are separate entities for tax purposes.

[4] Indeed, the Church's official policy letter states that "[p]rice cuts are forbidden under any guise" and "PROCESSING MAY NEVER BE GIVEN AWAY BY AN ORG." (App., *infra*, 15a-16a n. 6). Free services are awarded only to fully contracted staff, on the condition that the staff member fulfill the terms of his contract (*ibid.*).

to purchase services (App., *infra*, 18a-19a). The court explained that the payments "were not voluntary transfers without consideration, but were made with the expectation of receiving a commensurate benefit in return" (*id.* at 20a). The court continued (*ibid.*): "[W]here contributions are made with the expectation of receiving a benefit, and such benefit is received, the transfer is not a charitable contribution, but rather a quid pro quo."

3. In the present case, a divided panel of the court of appeals reversed the Tax Court's decision in the Commissioner's favor that had been entered on the authority of *Graham* (App., *infra*, 1a-11a). Quoting *United States* v. *American Bar Endowment*, 477 U.S. 105, 116 (1986), the majority acknowledged that " '[a] payment of money generally cannot constitute a charitable contribution if the contributor expects a *substantial* benefit in return' " (App., *infra*, 4a (emphasis in original)). But the majority held that respondents' payments to the Church qualify as deductible donations, reasoning that such payments "constitute the transfer of money without adequate consideration in the economic sense because of the nature of what is received, and the *quo* of religious experience can never be considered the equivalent of the *quid* of a money payment" (*id.* at 7a). Judge Newman dissented, stating that Section 170 grants no special preference to payments made for participation in religious practices (App., *infra*, 8a-11a).

REASONS FOR GRANTING THE PETITION

The question presented in this case is identical to that presented in the consolidated cases of *Hernandez* v. *Commissioner*, cert. granted, No. 87-963 (Apr. 18, 1988), and *Graham* v. *Commissioner*, cert. granted, No. 87-1616 (May 23, 1988), where the taxpayers, like respondents, are

seeking to take a charitable deduction for payments made to the Church of Scientology. *Hernandez* is another of the cases that was decided in the Tax Court on the basis of a stipulation to adopt the findings of fact in the *Graham* case (see note 2, *supra*). Accordingly, it would be appropriate for the Court to hold this case pending the disposition of *Hernandez* and *Graham*.

CONCLUSION

The petition for a writ of certiorari should be disposed of as appropriate in light of this Court's decision in *Hernandez* v. *Commissioner*, No. 87-963, and *Graham* v. *Commissioner*, No. 87-1616.

Respectfully submitted.

CHARLES FRIED
Solicitor General

JULY 1988

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Docket No. 86-4026

MICHAEL F. AND NANCY S. FOLEY,
PETITIONERS-APPELLANTS

-against-

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT-APPELLEE

No. 428—August Term, 1986

(Argued December 3, 1986, Decided April 19, 1988)

Before: NEWMAN, WINTER and MINER, *Circuit Judges.**

Appeal from a decision of the United States Tax Court (Sterrett, C.J.), disallowing income tax deduction for payments to Church of Scientology and assessing deficiency.

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* Judge Mansfield, originally a member of the panel, died on January 7, 1987. Pursuant to Local Rule § 0.14(b), Judge Winter was designated to replace Judge Mansfield.

MINER, *Circuit Judge.*

I.

This is an appeal from a decision of the United States Tax Court (Sterrett, C.J.) disallowing an income tax deduction of $5,881.83 paid by appellants to the Church of Scientology, Mission of Burbank, now the Mission of Los Angeles, California, in 1976 and assessing a deficiency in the sum of $975.92. The payments were made in connection with the appellants' participation in religious practices known as "auditing" and "training" in the Church of Scientology. No trial was conducted in this case, the parties having stipulated to be bound by the findings of fact and conclusions of law made in three "test" cases then pending in the tax court. The parties also stipulated "that to the extent relevant the records in said [three test cases] shall be deemed part of the record herein for purposes of any . . . appeal." App. at 12. The test cases concluded in the tax court with a decision in favor of the Commissioner, *Graham v. Commissioner*, 83 T.C. 575 (1984), and the tax court entered its decision assessing a deficiency in the case at bar accordingly. The *Graham* case was affirmed on appeal to the Ninth Circuit Court of Appeals, which held that the fixed donations required to participate in the religious practices in question do not qualify for the deduction for religious contributions authorized by § 170 of the Internal Revenue Code of 1954. *Graham v. Commissioner*, 822 F.2d 844 (9th Cir. 1987). Faced with the same issues, the First Circuit Court of Appeals also held in favor of the Commissioner. *Hernandez v. Commissioner*, 819 F.2d 1212 (1st Cir. 1987). The Eighth Circuit Court of Appeals, however, has held that "payments to the Church of Scientology for participation in strictly religious practices were contributions within the meaning of section

170." *Staples v. Commissioner*, 821 F.2d 1324 (8th Cir. 1987). We agree with the Eighth Circuit and reverse.

II.

The Church of Scientology is a religious organization exempt from tax under the provisions of the Internal Revenue Code, 26 U.S.C. § 501(c)(3).[1] Those who adhere to the tenets of the Church participate in the rituals of auditing and training, the central religious experiences of Scientology. The practice of auditing involves a one-to-one encounter between the participant and a church staff member designated as the "auditor." The purpose of these encounters is to raise the spiritual awareness of the participant to the highest level through a series of progressive steps. Scientologists believe that the enhancement of civilization is linked to the spiritual goals to which they aspire. They undertake the experience of training for the purposes of studying church doctrine and scripture and of attaining the background needed to qualify as auditors. Training is intended to enlighten participants and to enable them to help others.

A schedule of payments for auditing and training sessions has been established by the Church. These payments are referred to as "fixed donations" or "fixed contributions." Participation in the sessions generally is conditioned on such payments, which are the major sources of funding for church operations and activities. The man-

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[1] The Commissioner stipulated in the three test cases, and therefore in this case, that the Church was an exempt religious organization. The stipulation came prior to the decision of the tax court in *Church of Scientology of California v. Commissioner*, 83 T.C. 381 (1984). In that case, the tax court upheld the revocation of the exemption of the Church of Scientology of California. That decision was affirmed by the Ninth Circuit Court of Appeals. 823 F.2d 1310 (9th Cir. 1987).

datory fee schedule is based on a religious tenet of Scientology known as the Doctrine of Exchange. According to this Doctrine, every person must give something for what he or she receives in order to maintain "inflow and outflow" and avoid spiritual decline. The fees established by the Church vary with the length and level of sophistication of the sessions. Advance payments are encouraged, and refunds for unused payments are given. It appears that the bulk of the contributions made by appellants related to the auditing sessions in which they participated. Whether the appellants are entitled to deduct as charitable contributions on their federal income tax returns the sums paid over to the Church of Scientology in connection with their participation in the Church practices of training and auditing is the issue presented by this appeal.

III.

The Internal Revenue Code provides that charitable contributions may be deducted from taxable income, 26 U.S.C. § 170(a), and defines such donations as contributions or gifts made to or for the benefit of certain specified entities, including those organized and operated exclusively for religious purposes, 26 U.S.C. § 170(c)(2)(B). "A payment of money generally cannot constitute a charitable contribution if the contributor expects a *substantial* benefit in return," *United States v. American Bar Endowment*, 106 S. Ct. 2426, 2433 (1986) (emphasis supplied), since "[t]he sine qua non of a charitable contribution is a transfer of money or property without adequate consideration," *id.* at 2434.

In the context of religious contributions, we have affirmed the disallowance of deductions for parochial school tuition payments, which clearly are made with the expectation of a definite economic benefit. *Winters v.*

Commissioner, 468 F.2d 778, 780 (2d Cir. 1972). Donations related to participation in religious observances, however, have not been regarded as yielding specific private benefits to the donor, who is considered only an incidental beneficiary, the primary beneficiaries of the observances being the members of the faith and the general public. Rev. Rul. 71-580, 1971-2 Cum. Bull. 235. Accordingly, the Commissioner has allowed deductions for the saying of masses, Rev. Rul. 78-366, 1978-2 C.B. 241, and for pew rents, building fund assessments and periodic dues, Rev. Rul. 70-47, 1970-1 C.B. 49, all involving fixed donations for participation in religious services. Presumably, specified payments for attendance at High Holy Day services, for tithes, for torah readings and for memorial plaques would fall into the same category.

Conceding the religious character of auditing and training in the Church of Scientology, the Commissioner argues that the appellants received *quid pro quo* or "commensurate benefits" in return for the payment of the fees specified for participation in the practices of the Church. According to the Commissioner, those benefits were substantial in nature and therefore fail to qualify as charitable contributions. Referring to testimony in the stipulated record regarding improvements in the lives of those who participate in Scientology observances, the Commissioner contends that the payments made by church members are exchanged for the fulfillment of their personal expectations. He therefore concludes that "[t]heir payments were not for services or programs designed for collective participation by the church membership as a whole," since "they purchased, by the hour, tailormade benefits for their private use." Appellee's Brief at 22-23. In advancing his "value received' theory, the Commissioner contends that "value" need not be of an economic or financial type.

The individual benefits gained by appellants through participation in their religious rituals, and the payment of fixed fees for that participation, cannot be considered so equivalent as to pass the donation/purchase line. Appellants were fully aware that the principal support of their church was derived from the payments received for auditing and training. As in the case of the deductible donation described previously, it must be presumed that the primary purpose of the donations was a charitable expectation that the religious causes of the Church would be furthered, *Murphy v. Commissioner*, 54 T.C. 249 (1970), and that only incidental benefits accrued to the individual donors. In any event, there is no way of measuring spiritual or religious benefits in such a way as to conclude that they are "commensurate" with the fees paid for participation in the religious activities giving rise to those benefits. The better rule is to avoid any attempted measurement and to hold "that regardless of the timing of the payments or details of the church's method of soliciting contributions from its members, an amount remitted to a qualified church with no return other than participation in strictly spiritual and doctrinal religious practices is a contribution within the meaning of section 170." *Staples*, 821 F.2d at 1327.

Finally, auditing and training are *the* religious practices of the Church of Scientology. Appellants are entitled to participate in those practices by making donations in accordance with a prescribed schedule. Their donations did not yield them any substantial economic benefit, because they received in return nothing of material value to themselves or to anyone else. Contrary to the Commissioner's argument, Appellee's Brief at 19-20, economic value can be identified where payments are made to an adoption agency to secure an adopted child, *Arceneaux v. Commissioner*, 36 T.C.M. 1461 (1977), to a charitable or-

ganization for admission to a concert, Rev. Rul. 67-246, 1967-2 Cum. Bull. 104, and to a museum for membership, Rev. Rul. 68-432, 1968-2 Cum. Bull. 104. Payments for religious services stand on a different footing. They constitute the transfer of money without adequate consideration in the economic sense because of the nature of what is received, and the *quo* of religious experience can never be considered the equivalent of the *quid* of a money payment.

IV.

Because we hold that the donations made by appellants for participation in the religious practices of their church were charitable contributions within the meaning of the Internal Revenue Code, and therefore deductible on their federal income tax returns, it is unnecessary for us to reach the merits of the constitutional arguments they have advanced. The decision of the tax court is reversed.

JON O. NEWMAN, *Circuit Judge*, dissenting:

The Church of Scientology offers "auditing" sessions at prices ranging from $50 to $100 an hour depending on the level of "intensity." The Church's price list states that quantity discounts are available; the $50 per hour price for the 12½ hour package drops to $42.50 per hour for the 100 hour package. Payments must be made in advance. A 5% discount is available for purchases prepaid substantially in advance. Partial refunds are available for sessions purchased but unused. The Church's advertising literature states that a participant in these auditing sessions can improve his health, memory, and communication skills. The Tax Court concluded that payments for the purchase of these auditing sessions were not charitable contributions under section 170 of the Internal Revenue Code. That conclusion has been upheld by the courts of appeals for three circuits. *Miller v. I.R.S.*, 829 F.2d 500 (4th Cir. 1987); *Graham v. Commissioner*, 822 F.2d 844 (9th Cir. 1987) (Kennedy, J.); *Hernandez v. Commissioner*, 819 F.2d 1212 (1st Cir. 1987), *petition for cert. filed*, 56 U.S.L.W. 3523 (U.S. Dec. 11, 1987) (No. 87-963); *contra Staples v. Commissioner*, 821 F.2d 1324 (8th Cir. 1987), *petition for cert. filed*, 56 U.S.L.W. 3592 (U.S. Feb. 19, 1988) (No. 87-1382). Because I agree with the views of the First, Fourth, and Ninth Circuits, I respectfully dissent.

The claim of deductibility raised by this appeal and similar appeals brough in each of the nation's circuits may not recur now that the Ninth Circuit has also upheld the Tax Court's revocation of the tax exemption of the Church of Scientology. *Church of Scientology of California v. Commissioner*, 823 F.2d 1310 (9th Cir. 1987), *affirming* 83 T.C. 381 (1984), *petition for cert. filed*, 56 U.S.L.W. 3592 (U.S. Feb. 16, 1988) (No. 87-1377). And the issues raised by the claim have been thoroughly discussed by the

courts of appeals that have already considered the matter. Nevertheless a few words are appropriate to point out the basis of my disagreement with the panel opinion of this Court.

The majority appears to set forth two basic rationales for its reversal of the Tax Court's decision. First, the majority says that "it must be presumed that the primary purpose of the donations was a charitable expectation that the religious causes of the Church would be furthered, *Murphy v. Commissioner*, 54 T.C. 249 (1970), and that only incidental benefits accrued to the individual donors." ____ F.2d at ____. On the contrary, it is the notice of tax deficiency that carries a presumption of correctness and requires the taxpayer to demonstrate otherwise. *Welch v. Helvering*, 290 U.S. 111, 115 (1933); *Schaffer v. Commissioner*, 779 F.2d 849, 857 (2d Cir. 1985). Moreover, in this case the Tax Court found, upon a record filled with the promotional literature of the Church of Scientology, that participants in the Church's auditing sessions received far more than incidental benefits, and those findings are not clearly erroneous. There is no basis for according the taxpayer a favorable presumption.

Second, and more fundamentally, the majority concludes that any payment made to a church for participating in *religious* practices of the church is entitled to be treated as a charitable deduction. That is a policy choice that perhaps could be made by Congress, subject to the limitations of the Establishment Clause, but it is a choice that Congress has thus far declined to make. Rather than make all payments for participating in religious practices automatically deductible, Congress has specified that a payment to an organization operated exclusively for religious and other eleemosynary purposes is deductible only if such a payment is a "contribution or gift." 26

U.S.C. § 170(c) (1982). No special preference is given to payments made for participating in religious practices.

Moreover, it is far from clear that Congress would want to legislate the blanket deductibility for religious practice payments that the majority has announced in this case. It may well be in conformity with the religious teachings of a church that its members educate their children in church-run schools and a church might well deem such attendance a religious practice, but payments for parochial school tuition are nonetheless not considered charitable contributions. *Winters v. Commissioner*, 468 F.2d 778 (2d Cir. 1972). Allowing deductibility of all payments made for a purpose that a church deems to be a religious practice would greatly expand the scope of the charitable contribution category beyond what Congress has provided.

In some cases it may be a close question whether a payment to a religious institution is a purchase of services primarily for the benefit of the payor and hence not deductible or a contribution to the institution with only incidental benefit to the payor and hence deductible. Payments for pew rentals and attendance at High Holy Day services are close to the line, and, as the Ninth Circuit has observed, not all of the Commissioner's prior rulings in this area may be defensible. *See Graham v. Commissioner, supra*, 822 F.2d at 850. The inquiry in each case is whether the payment "is intended to benefit the charity without reference to a reciprocal and specific benefit to the donor, whether or not the benefit is religious." *Id.* at 849. In this case, that issue is not even close. Auditing sessions are advertised, priced, and marketed by the seller and bought by the customer as specific benefits for the purchaser, and the Tax Court could hardly have found otherwise.

Appellants' constitutional contentions, not reached by the majority, are not persuasive in my view, for reasons fully set forth in *Graham, Miller,* and *Hernandez.*

For these reasons, I dissent.

APPENDIX B

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

Docket No. 12357-79

MICHAEL F. AND NANCY S. FOLEY,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT

ORDER AND DECISION

After due consideration of petitioners' Motion for Entry of Final Decision filed December 2, 1985, respondent's Notice of Objection filed December 23, 1985, and petitioners' Response to Notice of Objection filed January 7, 1986, and on the authority of *Graham v. Commissioner*, 83 T.C. 575 (1984), on appeal (9th Cir., Nov. 19, 1984), it is

ORDERED that petitioners' above-referenced Motion for Entry of Final Decision is granted. It is further

ORDERED and DECIDED that there is a deficiency in petitioners' income tax for the taxable year 1976 in the amount of $975.92.

/s/ SAMUEL B. STERRETT
Samuel B. Sterrett
Chief Judge

Entered: MAR. 6, 1986

APPENDIX C

UNITED STATES TAX COURT REPORTS

Docket Nos. 5837-76, 9384-79, 374-80

KATHERINE JEAN GRAHAM, ET AL.,[1] PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Filed October 15, 1984

STERRETT, *Judge:* In these consolidated cases, respondent determined deficiencies in petitioners' Federal income taxes as follows:

Docket No.	*Petitioner*	*TYE Dec. 31 –*	*Deficiency*	*Date of deficiency notice*
5837-76	Katherine Jean Graham[2]	1972	$316.24	Apr. 7, 1976
9384-79	Richard M. Hermann	1975	803.00	Apr. 4, 1979
374-80	David Forbes Maynard	1977	643.00	Nov. 14, 1979

This issues before the Court are: (1) Whether payments made by petitioners to the various churches of Scientology[3] were deductible charitable contributions, and (2) whether denial of the claimed deductions would violate petitioners' constitutional rights.

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[1] Cases of the following petitioners are consolidated herewith: Richard M. Hermann, docket No. 9384-79; David Forbes Maynard, docket No. 374-80.

[2] Petitioner Graham was unmarried during the tax year in question. Subsequently, she married, and her married name is Mrs. Elliott.

[3] For convenience, these various churches of Scientology will be referred to as either the Church of Scientology or the Church.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulations of fact, together with the exhibits attached thereto, are incorporated herein by this reference. The parties specifically stipulated to the entire record in *Church of Scientology of California v. Commissioner*, 83 T.C. 381 (1984). All relevant findings of fact and court rulings from that case will be incorporated into this opinion. Since neither party argued to the contrary, it will be assumed that the Church of Scientology continued to operate at all relevant times in the same manner as it did in *Church of Scientology of California v. Commissioner, supra.*

For purposes of this litigation only, respondent did not contest petitioners' contentions that: (1) Scientology was at all relevant times a religion; (2) each Scientology organization to which petitioners paid money was at all relevant times a church within the meaning of section 170(b)(1)(A)(i),[4] and (3) Scientology was at all relevant times a corporation described in section 170(c)(2) and exempt from general taxation under section 501(a) as an organization described in section 501(c)(3).

Petitioners' residences at the time they filed their respective petitions in this case, and the places they filed their timely income tax returns for their respective years are as follows:

Petitioner	*Residence*	*TYE Dec. 31 –*	*Appropriate office of IRS*
Graham	Honolulu, HA	1972	Honolulu, HA
Hermann	Los Angeles, CA	1975	Fresno, CA
Maynard	Rialto, CA	1977	Fresno, CA

[4] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954 as amended and in effect during the taxable years in issue.

Petitioners were at all relevant times Scientologists. Scientology[5] teaches that the individual is a spiritual being having a mind and a body. Part of the mind, called the "reactive mind" is unconscious. It is filled with mental images that are frequently the source of irrational behavior. Through the administration of a Scientology process known as "auditing," an individual, called a "preclear," is helped to erase his reactive mind and gain spiritual competence. Auditing is also referred to as "processing," "counseling," and "pastoral counseling."

Scientologists believe that they can attain benefits from auditing and training, but only in degrees or steps. These include levels called "Grades" and higher levels called "OT sections." The various steps or degrees of accomplishment are set forth in a chart entitled "Classification Gradation and Awareness Chart of Levels and Certificates."

A trained Scientologist, known as an "auditor," administers the auditing. He is aided by an electronic device called an "E-meter." This device helps the auditor identify the preclear's areas of spiritual difficulty by measuring skin responses during a question and answer session. These auditing sessions are offered in fixed blocks of time called "Intensives."

One of the tenets of Scientology is that, anytime a person receives something, he must pay something back. This is called the doctrine of exchange. The Church of Scientology applies this doctrine by charging a "fixed donation" for training and auditing. With few exceptions, these services are never given for free.[6] Thus, fixed donations are

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[5] For an indepth review of the Scientology religion and its structure, see *Church of Scientology of California v. Commissioner*, 83 T.C. 381 (1984).

[6] The Church of Scientology has a nine-volume encyclopedia of Scientology policy called the OEC series. Hubbard Communications

generally a prerequisite to a person's receiving auditing and training. These fixed donation payments constitute the majority of the Church of Scientology's funds, and are used to pay the costs of church operations and activities.

The general rates of the fixed donations for auditing in 1972 were as follows:

12½-Hour intensive	$625
25-Hour intensive	1,250
50-Hour intensive	2,350
75-Hour intensive	3,350
100-Hour intensive	[7]4,260

In addition, the Church of Scientology offered two specialized types of auditing for a higher fixed duration –

Integrity Process	$750 per 12½-Hour intensive
Expanded Dianetics	$950 per 12½-Hour intensive

Members of the Church of Scientology are encouraged to make advance payments for Scientology courses. If payment is made well in advance of the services to be rendered, a discount of 5 percent can be obtained by the member. When a parishioner makes an advance payment,

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Office Policy Letter (HCO PL) Sept. 27, 1970 (Issue I), 3 OEC 89, describes the Church of Scientology's policy against free services and price cutting. It states:

> Price cuts are forbidden under any guise.
>
> 1. PROCESSING MAY NEVER BE GIVEN AWAY BY AN ORG. Processing is too expensive to deliver.
>
> • • • • •
>
> 9. ONLY FULLY CONTRACTED STAFF IS AWARDED FREE SERVICE, AND THIS IS DONE BY INVOICE AND LEGAL NOTE *WHICH BECOMES DUE AND PAYABLE IF THE CONTRACT IS BROKEN*. [Emphasis added.]

[7] Historically, the price of a 25-hour intensive was fixed at an amount equal to 3 months of pay for the average middle-class worker in the district of the Scientology Church providing the service.

the Church credits his account. Once the individual begins receiving a service, his account is debited. It is the Church of Scientology's policy to refund advance payments upon request at any time before services are received.[8]

The Church of Scientology operates in a commercial manner in providing these religious services. In fact, one of its articulated goals is to make money. This is expressed in HCO PL March 9, 1972, MS OEC 381, 384. It sets out the governing policy of the Church of Scientology's financial offices by exhorting these offices to "MAKE MONEY * * * MAKE MONEY. * * * MAKE MORE MONEY. * * * MAKE OTHER PEOPLE PRODUCE SO AS TO MAKE MONEY." The goal of making money permeates virtually all of the Church of Scientology's activities—its services, its pricing policies, its dissemination practices, and its management decisions.

The Church of Scientology promotes its services through free lectures, congresses, free personality tests, and handouts. Advertisements are placed in newspapers, magazines, and on the radio. These promotional activities are geared to be responsive to community concerns, which are determined from surveys.

In 1972, Graham made payments totaling $1,682 to the Church of Scientology, Hawaii, and to the Scientology and Dianetic Center of Hawaii. Of this amount, approximately $400 went towards training, the balance went for auditing. These payments were for the Hubbard Qualified Scientologist course (HQS), Communications course, and auditing. Some of the payments toward courses were for Graham's daughters, Karen and Laurel. When Graham made those payments, she expected to receive, and did

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[8] No evidence was produced with respect to the actual amounts, if any, of such refunds during the tax years in issue.

receive, the benefit of those services. On her 1972 income tax return, Graham deducted $1,682 as a charitable contribution.

In 1975, Hermann paid the Church of Scientology, American Saint Hill Organization (ASHO) $4,875. At the time Hermann made these transfers, he expected to receive Class 0 to 9 training. While Hermann did not take these courses, he did take other Scientology courses and has received auditing between 1974 and the present. On his 1975 income tax return, Hermann deducted $3,922 as a charitable contribution.

In 1977, Maynard paid the Church of Scientology, Mission of Riverside, $4,698.91 as advance payments for services. While Maynard did not receive any services in 1977, he made those remittances with the expectation of taking Interiorization Processing, Expanded Dianetics, and auditing. On his 1977 income tax return, Maynard claimed a $5,000[9] charitable contribution deduction.

In the respective notices of deficiency, respondent disallowed these claimed charitable contribution deductions. Respondent maintains that it was not established that the payments to the Church of Scientology were contributions or gifts rather than payments for services or merchandise.

OPINION

Issue 1. Deductibility of Payments Made

The taxpayer has the burden of proving that a particular payment is a "contribution or gift." *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934); *Welch v. Helvering*, 290 U.S. 111 (1933); Rule 142(a), Tax Court Rules of

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[9] This amount consisted of a $2,385 carryover from 1976 transfers and $2,615 for transfers in 1977.

Practice and Procedure. Petitioners argue that their remittances to the Church of Scientology met the statutory requirements of section 170, subsections (a) and (c), and thus were deductible charitable contributions. Respondent maintains that those payments were not "contribution[s] or gift[s]" within the meaning of section 170(c). Rather, he insists they were made to purchase services, i.e., a quid pro quo, and thus were nondeductible personal expenditures.

Section 170(a)(1) allows as a deduction any charitable contribution payment which is made within the taxable year. Section 170(c) defines the term "charitable contribution" as "a contribution or gift." Neither section 170 nor the regulations further elaborate on the meaning of "charitable contribution." This issue was addressed, however, in *DeJong v. Commissioner*, 36 T.C. 896 (1961), aff'd. 309 F.2d 373 (9th Cir. 1962). There, the Court stated—

> As used in this section the term "charitable contribution" is synonymous with the word "gift." * * * A gift is generally defined as a *voluntary transfer* of property by the owner to another *without consideration* therefor. If a payment proceeds primarily from the incentive of anticipated benefit to the payor beyond the satisfaction which flows from the performance of a generous act, it is not a gift. * * * [*DeJong v. Commissioner, supra* at 899. Citations omitted; emphasis added.]

Petitioners wanted to receive the benefit of various religious services provided by the Church of Scientology. The Church of Scientology, however, generally provided those services only if they were purchased. To encourage such purchases, the Church of Scientology gave a 5-percent discount to parishioners who made advance payments. A person who made an advance payment but

chose not to receive the services could request a refund of his money. Petitioners thus made payments to the Church in exchange for those services.

The record demonstrates clearly that these payments were not voluntary transfers without consideration, but were made with the expectation of receiving a commensurate benefit in return. In addition, where contributions are made with the expectation of receiving a benefit, and such benefit is received, the transfer is not a charitable contribution, but rather a quid pro quo. *Haak v. United States*, 451 F. Supp. 1087, 1090-1091 (W.D. Mich. 1978).

Petitioners Graham and Hermann made payments for which they received religious services. They received a perceived benefit from their transfers. Petitioner Maynard made advance payments to the Church of Scientology. While he did not receive any religious services in 1977, his account was credited for his remittances. This credit entitled him to receipt of services in the future. It was that entitlement which constituted his receipt of a perceived benefit, or the quid pro quo.

Accordingly, none of the payments petitioners made were charitable contributions within the meaning of section 170(c). Instead, they were nondeductible personal expenditures.

Issue 2. Constitutional Arguments

Petitioners maintain that denial of the deduction interferes with their constitutional right to the free exercise of their religion. It is well established that there is no constitutional right to a tax deduction. Benefits granted to taxpayers, such as deductions for charitable contributions, are matters of legislative grace. *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593 (1943); *New Colonial*

Ice Co. v. Helvering, supra at 440; *Winters v. Commissioner*, 468 F.2d 778, 781 (2d Cir. 1972), affg. a Memorandum Opinion of this Court. Further, denial of this deduction does not violate the free exercise clause of the First Amendment. *Parker v. Commissioner*, 365 F.2d 792, 795 (8th Cir. 1966), cert. denied 385 U.S. 1026 (1967); *Winters v. Commissioner, supra* at 781. The constitutionality of the denial of this deduction was well stated by the Supreme Court in *Cammarano v. United States*, 358 U.S. 498, 513 (1959)—

> Petitioners are not being denied a tax deduction because they engage in constitutionally protected activities, but are simply being required to pay for those activities entirely out of their own pockets, as everyone else engaging in similar activities is required to do under the provisions of the Internal Revenue Code. * * *

Respondent is not precluding petitioners from engaging in constitutionally protected activities. Petitioners may practice their beliefs; they just will not be subsidized for them.

Even if denial of the deduction interfered with petitioners' practice of their religious beliefs, not all burdens on religion are unconstitutional. *United States v. Lee*, 455 U.S. 252, 257 (1982). See also, e.g., *Prince v. Massachusetts*, 321 U.S. 158, 163-166 (1944); *Reynolds v. United States*, 98 U.S. 145, 166-67 (1878). The limitation on religious liberty can be justified by showing that it is essential to accomplish an overriding governmental interest. *United States v. Lee, supra* at 257-258. The Supreme Court has stated that "Because the broad public interest in maintaining a sound tax system is of such a high order, religious belief in conflict with the payment of taxes affords no basis for resisting the tax." *United States v. Lee, supra* at 260.

Petitioners also argue that denial of the deductions violates the establishment clause of the First Amendment.[10] Their argument is twofold. First, disallowance would result in disparate treatment of petitioners, in violation of the neutrality requirement of the First Amendment. Second, disallowance would be the result of excessive Government entanglement with religion, in violation of the First Amendment.

Petitioners place heavy emphasis on *Larson v. Valente*, 456 U.S. 228 (1982). In that case, Minnesota had enacted a statute imposing registration and reporting requirements on religious groups which solicited more than 50 percent of their contributions from nonmembers. The Supreme Court held that the statute violated the establishment clause of the First Amendment. In so doing, they rejected an argument that the statute was facially neutral and found instead that it made "explicit and deliberate distinctions between different religious organizations." *Larson v. Valente, supra* at 247 n. 23. The Court further mentioned that "The fifty percent rule of section 309.515, subd. 1(b), effects the *selective* legislative imposition of burdens and advantages upon particular denominations." *Larson v. Valente, supra* at 253-254.

The instant case is distinguishable from *Larson* because section 170, unlike the charitable solicitation law in *Larson*, does not make classifications among religions. Furthermore, unlike *Larson*, here there is no legislative history revealing overt discrimination. Finally, even if section 170 has the effect of advancing one religion more than another, that fact alone does not make the statute un-

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[10] Petitioners raised similar establishment clause arguments in *Church of Scientology of California v. Commissioner*, 83 T.C. at 447-454. While that case dealt with the constitutionality of sec. 501(c)(3), its rationale is fully applicable to sec. 170 and we incorporate herein by this reference that portion of the opinion.

constitutional. The establishment clause does not prohibit a statute from having a disparate impact on religious organizations provided the disparate impact results from the application of secular criteria. *Lynch v. Donnelly*, 465 U.S. ____, ____ (1984); *Gillette v. United States*, 401 U.S. 437, 452 (1971); *McGowan v. Maryland*, 366 U.S. 420, 442-444 (1961). Here the tests for determining the deductibility of claimed charitable contributions are based on secular criteria. Further, *Larson* is distinguishable from the case at bar because the section 170 classification bears equally upon all religious organizations. Thus, there is not the political divisiveness here that was prevalent in *Larson*. Accordingly, the argument of unconstitutionality under the establishment clause is rejected.

Finally, petitioners insist that denial of the claimed deductions was due to selective discriminatory action. They claim that their rights under the First Amendment and the equal protection component of the due process clause of the Fifth Amendment were violated. The evidence in this case does not demonstrate that any discriminatory action was taken against petitioners by respondent or any of his agents. Petitioners have failed to prove that violation of their rights occurred under either the First or Fifth Amendments.[11]

Decisions will be entered for the respondent.

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[11] This issue of selective enforcement was also raised and rejected in *Church of Scientology of California v. Commissioner*, 83 T.C. at 453-454.

APPENDIX D

Section 170 of the Internal Revenue Code (26 U.S.C.) provides in pertinent part:

Charitable, etc., contributions and gifts

(a) Allowance of deduction

(1) General rule. – There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.

* * * * *

(c) Charitable contribution defined. – For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of –

(1) A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

(2) A corporation, trust, or community chest, fund, or foundation –

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B). * * *

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